Office - Supreme Court, U. S.
FILED
SEP 16 1950
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

October Term, 1950

No. 193

WHITE BROTHERS COMPANY,

Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit.

REPLY TO RESPONDENT'S BRIEF.

FRANK S. NORMANN,
Attorney for Petitioner.

CITATIONS.

	PAGE
Breuner, John, Co. v. Commissioner, 179 F. 2d 685, certiorari denied 339 U. S. 967	3
Commissioner v. Shenandoah Co., 138 F. 2d 792	2
Commissioner v. South Texas Lumber Co., 333 U. S. 496	3
Commissioner v. Wheeler, 324 U. S. 542	3
Kimbrell's Home Furnishings, Inc. v. Commissioner, 159 F. 2d 608	4
May, Stern & Co. v. Commissioner, 181 F. 2d 407, pending on petition for certiorari, No. 91	3

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1950

No. 193.

WHITE BROTHERS COMPANY,
Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit.

REPLY TO RESPONDENT'S BRIEF.

The Brief in Opposition filed by the Commissioner of Internal Revenue purports to set forth four reasons why taxpayer's petition for a writ of certiorari should be denied. Because Petitioner believes that the Commissioner misstates the issue of the case as well as makes incorrect and unwarranted deductions from the statute and the cases, he requests consideration of this reply to Commissioner's Brief.

First—The Commissioner states that "the principle embodied in statutory language by Section 115(*l*) was always the determinative rule for computing earnings and profits". Although this statement is patently incorrect, this case does not hinge upon determination of "earnings and profits" but upon "surplus available for dividends". There is no judicial authority for the Commissioner's action, for the only case in which *surplus,* as affected by Section 115(*l*), has been defined is *Commissioner v. Shenandoah Company,* 138 F. 2d 792, at page 794:

> "Nothing in Sec. 501 limits, or purports to limit, earnings and profits from sales of property to those which were 'recognized' by the taxpayer as taxable to him in the year in which the dividend was declared. It merely limits them to such as were 'recognized', in computing net income, under the law applicable to the year in which the sales were made, and it stands conceded that the Revenue Act of 1936, the law applicable, clearly recognizes the receipts in this case as gains, and, but for the option to defer payment of taxes on them it would have subjected the taxpayer to taxes on them in the year of their receipt. All that Section 501 does, all that it was intended to do, is to limit usable earnings and profits from sales of property to that portion of the gain realized which is taxable, and there is nothing in it which restricts such usable profits to those gains only which are returned for taxation in the year of their realization. Usually, of course, the year of realization is the year of taxation, and this would be the case here but for the use of the installment option. This, while deferring payment of the taxes to a later year, does not change the fact that the income was in fact realized in the year

> in which the obligations were received. Indeed, it establishes that it was, for otherwise there would be no occasion to provide for deferring the payment. We think it plain, therefore, that the Tax Court was right in holding that dividends paid out of earnings taxable when received, under the Revenue Act applicable to the year in which the sales were made, though under the option not taxed to them in those years, were paid out of surplus."

Completely ignoring this decision, the only one that purports to discuss the inclusion of installment sales receivables among the assets of a corporation to determine whether it has a surplus available for dividends, the Commissioner suggests that *Commissioner v. Wheeler*, 324 U. S. 542 and *Commissioner v. South Texas Lumber Co.*, 333 U. S. 496 deal with the same question. Such is not the case, for they discuss earnings and not surplus. *Commissioner v. Shenandoah Company, supra*, stands unchallenged as the only carefully reasoned consideration of the problem.

Second—Contrary to the Commissioner's statement, petitioner makes no claim that its election under Section 736(a) alters the status of its earnings during the years 1921-1924 and 1929. Section 736(a) can have no meaning except as it refers to installment sales receivables *outstanding on December 31, 1939*. In *John Breuner Co. v. Commissioner*, 179 F. 2d 685, and *May, Stern & Co. v. Commissioner*, 181 F. 2d 407, the issue regarding Section 736(a) arose only because the installment receivables from sales made in years prior to 1940 had not been collected as of December 31, 1939. Petitioner is not attempting, as

the taxpayers in the foregoing cases did, to include in equity invested capital earnings that had never been reported for income tax. The income, pertinent to this controversy, was derived from operations during years between 1920 and 1930, and long before the excess profits tax was enacted in 1940, had been taken into taxable income and reported for any and all taxes then in effect. Receivables of the type dealt with in the *Breuner* and *May, Stern* cases are not at issue in this case.

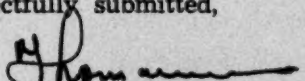
Third—Without being too precise in his argument, in effect the Commissioner contends that because petitioner did not pay excess profits taxes on the income derived from installment sales and paid out in dividends during the years 1921-1924 and 1929—years when such a tax was not levied—taxpayer does not meet the requirements of Section 736. The answer to this argument, if any is needed, is to be found in *Kimbrell's Home Furnishings, Inc. v. Commissioner*, 159 F. 2d 608, where it is said: "The purpose of (Section 736) was to place installment sellers on an equal footing with other taxpayers on an accrual basis", and a little later, "The accumulated earnings and profits of a taxpayer on an ordinary accrual basis undoubtedly include the uncollected profits in its accounts receivable". The "ordinary accrual basis" taxpayer did not pay excess profits taxes during the 1920s but by the application of singularly tortious semantics the Commissioner is attempting to penalize petitioner because it did not.

Fourth—The Commissioner implies that "earnings" and "surplus" are synonymous terms and that any dividends

paid from an untaxed surplus represent a return of capital not subject to tax in the hands of the stockholders. Such a conclusion of law has never been expressed by this Court, and petitioner earnestly contends that it should not be established by indirection and in connection with a collateral issue. Although the Commissioner implies (p. 12) that this case is of little importance, the argument he uses against petitioner, followed to its logical conclusion, will enable the stockholders of many corporations to escape taxation on dividends paid to them. Perhaps most installment sales corporations reporting under Section 44 of the Internal Revenue Code normally have their surplus invested in uncollected receivables, so that a technical deficit, as contended for by the Commissioner in this case, exists for them. By carefully choosing the years for payment they could make distributions to the stockholders that would not be subject to income tax. This being the case, the Commissioner, not taxpayer, should be prosecuting any appeal necessary to prevent the judicial crystalization of such an unsound principle of taxation.

For these reasons and those contained in the petition filed on July 10, 1950, petitioner respectfully submits that a writ of certiorari to review the judgment of the Court of Appeals for the Fifth Circuit should be granted.

Respectfully submitted,



FRANK S. NORMANN,
Attorney for Petitioner,
1605 Hibernia Building,
New Orleans, Louisiana.